Kapstream
— JANUS HENDERSON —

Monthly Report – I class units

KANGANEWS AWARDS 2018 WINNER – AUSTRALIAN CREDIT FUND MANAGER OF THE YEAR
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Fund objective

The fund aims to provide a superior stream of income and capital stability over the medium term while aiming to outperform its benchmark through market cycles.

Fund application

Investors seeking to enhance their overall fixed income returns with a higher yielding, predominantly investment grade (IG), absolute return-oriented global fixed income portfolio.

Fund details

Inception date	16 August 2018
Fund size	AUD 307m
Distribution frequency	Quarterly
Management fee	0.45% p.a.
Buy/sell spread	0%[1]/0.20%

Fund statistics

Interest rate duration	0.45 yrs
Credit spread duration	2.07 yrs
Current yield	3.79%
Average credit rating	BBB
Number of issuers	56

Fund guidelines

Target return	cash plus 3-4%
Target volatility	<3% annualised
Duration limit	-2 to +2 yrs
Credit quality	>75% investment grade

Steve Goldman
Portfolio Manager

Dylan Bourke
Portfolio Manager

August 2021

Performance (%)	1 month	3 months	6 months	1 year	calendar year to date	annualised since inception
Fund Return *(before fees and sell spread)*	**0.35**	**0.92**	**1.75**	**3.96**	**2.04**	**3.29**
Fund Return *(after fees, before sell spread)*[1]	0.31	0.80	1.51	3.47	1.72	2.80
Fund Return *(after fees and sell spread)*[2]	0.31	0.80	1.51	3.79	1.88	2.77
RBA Cash Rate	0.01	0.03	0.05	0.13	0.07	0.70
Active return[3] *(before fees and sell spread)*	**0.34**	**0.89**	**1.70**	**3.83**	**1.97**	**2.59**
Active return[3] *(after fees and sell spread)*[2]	0.30	0.77	1.46	3.66	1.81	2.08
Ausbond Bank Bill Index	0.00	0.01	0.02	0.04	0.02	0.85

Past performance is no guarantee of future results. Net of fee returns inclusive of 0.4632% annualised total expenses. No allowance is made for tax. Numbers may not add due to rounding. 1) For a continuing investor the actual return experienced based on the NAV performance of the Fund, after accounting for management fees. 2) The return experienced by a redeeming investor, based on the exit price performance of the Fund which accounts for the start and end of period sell spread level (see additional note on sell spreads at the end of this report), and management fees. 3) Active return of the Fund compared to Benchmark (RBA Cash Rate). Source: Fidante Partners Limited, 31 August 2021.

Performance commentary

The Fund returned 0.35% before fees in August and delivered close to the top end of its cash plus 3-4% target range over the trailing twelve-month period. The largest contributor over the month was coupon income followed by idiosyncratic credit tightening. The portfolio's interest rate exposure of 0.45yr detracted as swap spreads and rates slightly sold off whilst credit spreads were relatively stable.

Portfolio strategy

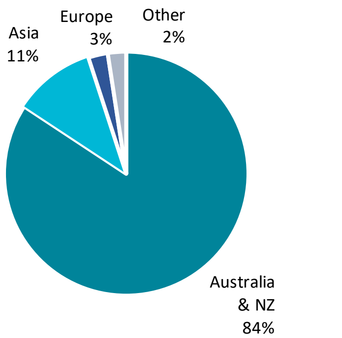
The fund rotated into exceptionally attractive new issues, maintaining the yield over 3%, while spread duration was steady at 2.1yrs. We believe this significant spread over the cash rate will provide a strong tailwind for returns going forward. Despite our expectation of strong technical support from central banks' accommodative policies, duration was reduced to 0.45yrs from 0.65yr as we believe there will be continued volatility in rate markets. We continue to run a barbell strategy, preferring short-dated lower rated credits given their expected resilience in a sell-off and concerns over credit spreads at relatively tight levels. Repo exposure increased to 2.7% largely matched to three-month maturity bonds as part of liquidity management.

The fund's recent purchases were market leaders in the securitised and financial sectors, where we see attractively priced securities. The average credit rating of our holdings was unchanged at BBB. Given the purchase of attractive new issues, high yield exposure was maintained around 20%. High yield holdings are typically BB-rated, short maturity bonds in the financial or securitised sectors where we have no concern around default risk. We continue to minimise or completely avoid exposure to the traditionally higher beta sectors such as commodities, energy, airlines and tourism.

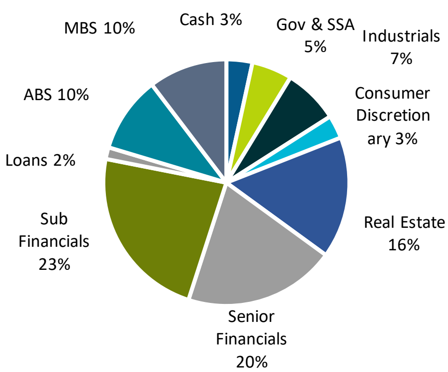
Our portfolio can be simply split across three major 'buckets'; financials (~43%), corporates (~28%), and asset and mortgage-backed (~20%) with the residual in cash and liquids. Geographically, we have an 84%/16% split between Australian and international issuers. Over the coming months, we expect to maintain the yield on the portfolio, as we continue to add from a very strong pipeline of investment opportunities.

In rates, we have ~0.35yrs Australasian duration and ~0.1yrs US interest rate duration for a total portfolio duration of ~0.45yrs. We believe there is merit in maintaining some level of neutral duration as a hedge for the credit book. Further, given the slack in the labour force, we believe central banks will keep rates low into 2022 even if the Fed does start tapering.

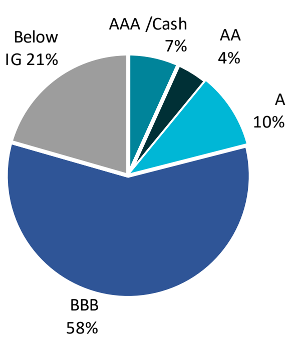
Geographic Allocation



Sector Allocation*



Credit Rating*



* Allocations are scaled to 100% due to repos

Outlook

In global markets, risk assets were broadly supported because hospitalisation rates remain low despite cases of COVID-19's Delta-variant continuing to grow. The S&P 500 was up, volatility trended lower with the VIX down 1.8 points to 16.5. Credit spreads were tighter, with both North American and Australian IG CDS indices contracting marginally, close to the tights on the year. Global rates sold off slightly, except in Australia due to prolonged lockdowns.

In the US, payrolls and inflation, continue to be robust. Non-farm payrolls were +943k relative to expectations of +870k leading unemployment to a post-pandemic low of 5.4% from 5.9% the prior month. Meanwhile, headline inflation was strong tracking at 5.4%, modestly above expectations of 5.3%. Transitory elements of the inflation basket - used cars, hotels and recreation showed slowing price increases. However, we expect persistently higher inflation over the short term due to supply-chain constraints caused by COVID-19 such as global shipping, transportation and storage costs (excluding fuel) continuing to be high. Jerome Powell at Jackson Hole confirmed conditions have been met for a tapering of the Fed's balance sheet in the coming months, arguing that tapering does not represent a tightening of financial conditions. As a result, focus will shift to potential interest rate hikes and rates were higher and curves steeper over the month. We expect the Fed to maintain rates at or near zero for the next couple of years with uncertainty as to the direction of inflation leading to volatility further out the curve.

In Australia, tightening of restrictions and ongoing lockdowns in New South Wales and Victoria, are weighing on investor sentiment. Business Conditions saw its largest monthly fall since the depths of 2020's COVID-19 crisis, down 13.5pts to 11, while Business Confidence is now in negative territory, down 18.5pts to -8. Earlier in the month, the RBA met and retained the current composition of monetary policy; rates at 0.1% and QE purchases at a rate of A$5bn per month. The RBA did not indicate they were prepared to delay tapering of asset purchases to $4bn per month in mid November. This suggests the RBA believes the current mix of monetary policy settings is sufficiently loose and that any loss of economic activity through lockdowns will rebound quickly in subsequent months. Intuitively, against this backdrop A$ rates rallied slightly, whilst swap spreads widened.

In Europe, the Bank of England also maintained unchanged policy settings, delivering a hawkish statement, acknowledging a "modest tightening" of settings will be required "to be consistent with meeting the inflation target sustainably". They also raised expectations for near-term inflation to 4% and forecasting a return to 2% in three years' time, highlighting concern that inflation may not be transitory. The European Central Bank did not meet, however Governing Council members' hawkish commentary increased, believing it is time to begin discussions on how to transition away from emergency stimulus as inflation and growth both rise across the region. As a result, German rates sold-off.

In Asia, the Bank of Korea hiked rates by 25 basis points to 0.75% focusing on potential financial imbalances and prolonged negative real rates as being harmful for markets and economic activity. In China, the partial shutdown of its major shipping port in Ningbo-Zhoushan (the third largest cargo port in the world) due to a COVID-19 Delta outbreak highlights the virus's unpredictable hold over global supply chains. Such a shutdown only serves to further delay the transitory inflation narrative and ensures transportation and storage costs remain elevated. Chinese data continues to print on the softer side; retail sales, industrial production and manufacturing PMIs all printing below expectations.

Fund sell spread[1]

The Fund's sell spread was maintained at 0.2% in August and the buy spread was maintained at 0% with a discretionary conditional buy spread of 0.1% if daily inflows exceed A$15m. These reflect more normalised transaction costs in fixed income securities. Sell spreads exists solely to protect unitholders from the impact of higher trading costs that the whole fund would otherwise face in meeting requests from the few investors who on any given day wish to withdraw any investment. It is not a manager fee, rather a mechanism that pays directly back into the Fund to ensure only withdrawing unitholders meet the transaction costs of a withdrawal. Please stay abreast of current sell spread levels which are published as a Continuous Disclosure Notice on our Responsible Entity's website at https://www.fidante.com/investment-managers/kapstream-capital.